

STATEMENT OF
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CHEVRON NORTH AMERICA EXPLORATION AND PRODUCTION COMPANY,
A DIVISION OF CHEVRON U.S.A. INC.,
BEFORE THE COMMITTEE ON GOVERNMENT REFORM
SUBCOMMITTEE ON ENERGY AND RESOURCES,
UNITED STATES HOUSE OF REPRESENTATIVES,
JULY 27, 2006, HEARING

Mr. Chairman and Members of the Subcommittee, on behalf of Chevron, I wish to express our appreciation for the opportunity to appear before the Subcommittee to discuss the Department of the Interior's deepwater royalty relief program.

As requested in your invitation to testify, my testimony will address various meetings with MMS during which the omission of price threshold language in certain deepwater leases was raised with Mr. Chris Oynes, the MMS Regional Director for the Gulf of Mexico. In addition, you asked that I provide my recollection of Mr. Oynes' reaction to the discussion, as well as to provide you with any other correspondence I may have had with the Interior Department during the 1995-2000 timeframe regarding price thresholds or related issues.

As stated in our letter to the Chairman on July 10, 2006, I came to the present Chevron organization from the legacy Texaco company, and participated in meetings with the MMS in which the 1998 and 1999 lease royalty relief issues were discussed. (In 1998, Chevron U.S.A. Inc. (Chevron), Texaco Exploration and Production Inc. (Texaco), and Union Oil Company of California (Unocal) were separate companies. Through a series of mergers and acquisitions, Texaco and Unocal are now owned by certain Chevron subsidiaries and affiliates.) In 1998 and 1999, I held the Land Manager's position at Texaco. Currently, I am Chevron's Gulf of Mexico Deepwater Land Manager. In that capacity, I am responsible for land related activities associated with the leasing, exploration, and major capital projects associated with Chevron's deepwater leases. In the period relevant to your inquiry, I was the Land Manager for the Gulf of Mexico at Texaco.

I am currently a member of the American Association of Professional Landmen's (AAPL) Outer Continental Shelf (OCS) Committee (the AAPL Committee). The AAPL Committee varies in size from year to year, but normally consists of representatives of 20 or more companies engaged in oil and gas exploration and production on the United States OCS. For many years, members of the AAPL Committee have met once per quarter with the MMS, generally with the Gulf of Mexico Regional Director Chris Oynes and his staff, to discuss a variety of issues related to the MMS's administration of offshore oil and gas leases. I participated in most of the quarterly meetings with MMS in 1998, 1999, and 2000.

I recall an AAPL Committee meeting with Mr. Oynes and his staff that took place in the fall of 1998 where the price threshold issue first was raised. During that meeting, I and others inquired about a change in deepwater royalty relief lease provisions in the leases issued as a result of the

OCS Lease Sale 169, which was held in March 1998. As you know, 1996 and 1997 deepwater leases included an addendum specifically detailing the terms and conditions of royalty relief applicable to each lease. The 1998 leases, however, had no such addendum. In the fall 1998 meeting, I and others questioned Mr. Oynes and his staff as to why royalty relief volume suspensions, price thresholds, and other matters were no longer detailed in addenda to the leases. Mr. Oynes and his staff indicated that they believed the addenda were no longer necessary because the MMS had finalized its royalty relief regulations. They further indicated that they believed the appropriate deepwater royalty relief terms and conditions were incorporated in the 1998 leases by language included in the leases making the leases subject to the new royalty relief regulations. That explanation was acceptable to me, and I did not pursue the issue further during the fall 1998 meeting.

After the fall 1998 meeting, I reviewed the Deepwater Royalty Relief Act and the MMS regulations implementing the Act. However, I concluded that neither the Act nor the regulations explicitly contained price threshold provisions applicable to leases issued in 1995 through 2000. In a 1999 meeting with Mr. Oynes, AAPL Committee members, including me, raised the fact we were unable to locate the provisions in both the Deepwater Royalty Relief Act nor the new implementing regulations addressing pricing thresholds. Mr. Oynes indicated his staff would review the issue.

After Texaco received leases purchased in OCS Lease Sale 175 (held in March of 2000), I and others noticed that the leases included an addendum addressing deepwater royalty relief. The new addendum referenced the royalty relief regulations and detailed the price thresholds to be applicable to the leases. These price thresholds were similar to the thresholds stipulated in the 1996 and 1997 deepwater leases. In an AAPL Committee meeting with MMS in 2000, I asked Mr. Oynes and his staff about the decision to revert to using an addendum containing the deepwater royalty relief provisions. The MMS representatives indicated that they believed the addendum was necessary to ensure that lessees understood the royalty relief terms and conditions applicable to their deepwater leases. In subsequent discussions with Mr. Oynes later in 2000, and again in 2001, Mr. Oynes indicated the MMS had concluded price thresholds would not apply to deepwater leases issued in 1998 and 1999 because neither the leases nor the regulations referenced in the leases contained price thresholds.

Unfortunately, I have no notes or written correspondence detailing my discussions with the MMS regarding the omission of price thresholds from 1998 and 1999 leases. I normally retain work files covering AAPL Committee activity for only a few years following any given meeting. Further, I should emphasize that in the late 1990s, the inclusion or absence of price thresholds in deepwater leases was not a significant issue for Texaco. In the late 1990s, Texaco did not anticipate the threshold prices established in the 1996 and 1997 leases would be exceeded in the near or even distant future. In that era, the most significant royalty relief issues for Texaco were MMS's implementation of royalty relief on a field basis, instead of by lease, and the complex royalty relief application process created by MMS for deepwater leases in existence prior to passage of the Deepwater Royalty Relief Act. These issues, rather than price thresholds, dominated discussions of royalty relief in the late 1990s.

Chevron continues to meet periodically with the MMS Regional office personnel both through the AAPL Committee and individually to address issues related to new regulations, notices issued to lessees, offshore operations, and other topics important to Chevron in the OCS. While we do not always agree with the MMS, we consider the job they do to be careful and conscientious particularly given the scope and magnitude of the OCS program and its detailed leases.

Chevron appreciates your continuing interest in deepwater royalty relief issues. Chevron believes that the Deepwater Royalty Relief Act has been a true success in that it has provided incentive for companies to purchase deepwater leases and to explore for oil and gas on the leases at a time of historically low prices. The magnitude of the investments in deepwater exploration would not have been made in that unfavorable price environment without the incentive of royalty relief. These investments will soon generate new supplies of oil and gas that are vitally needed in the current constricted and unstable energy market. In addition, the bonuses and rental payments for these deepwater leases have already generated considerable revenue for the federal government.

With 20-20 hindsight on price performance, it is easy to question how thresholds could have been omitted from leases sold in the 1998 and 1999 lease sales. However, at the time it seemed most unlikely the established thresholds would be exceeded or, indeed, have any relevance at all. Moreover, in today's environment when setting new price thresholds for royalty relief with respect to deepwater leases Chevron believes the recent increases in exploration and production costs should be an important consideration. As oil and gas prices have risen across the globe, it has become dramatically more expensive to procure the services and equipment necessary to explore for and produce oil and gas in the domestic deepwater as well as elsewhere in the world. One major example is the runaway cost for deepwater drilling rigs, which has doubled in the past year and can now run well in excess of \$500,000 per day.

In closing, I would like to reiterate that, as Mr. Siegele indicated at the June 21 hearing, Chevron is more than willing to meet with the MMS to discuss the issue of the omission of price thresholds in 1998 and 1999 deepwater leases. Indeed, we are pleased to inform you that we are scheduled to meet with MMS tomorrow to address the best way to resolve this issue in a way which is fair and equitable to all concerned parties.